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The Financial Liquidation of the War

War Debts and Reparation: A Statement of the Problem

AT a meeting in Geneva on September 16, representatives of the six powers directly concerned with reparation unanimously decided to establish a new committee of experts to work out a "complete and definite settlement of the reparation problem." Although the membership of the new committee and the terms of its appointment are yet to be determined, it is certain to be called upon to reconsider the whole question of Germany's obligations.

The *communiqué*, drafted by M. Briand and given out after the meeting in Geneva, reads as follows:

"Agreement has been reached on the opening of official negotiations relating to early evacuation of the Rhineland; the necessity for a complete and definite settlement of the reparation problem and the constitution for this purpose of a committee of financial experts to be nominated by Germany, France, England, Italy, Belgium and Japan; the acceptance in principle of creation of a commission of verification and conciliation, its composition and operation being the object of negotiations between the governments concerned."¹

The decision to appoint another committee of experts marks a new and decisive step in the history of reparation. It is the first time since the war ended that a final solution of the reparation problem has been undertaken. The Experts' Plan² is not, nor was it intended to be, a permanent solution. Its great value has been in providing a practicable schedule of payments to tide over a difficult period until the European situation should improve and a permanent settlement become possible. In the opinion of many European statesmen and financiers, the Experts' Plan has already fulfilled the purpose for which it was created and it is now time to proceed to a final settlement of the whole problem.

It is apparent, however, from recent press dispatches that the preliminary negotiations have brought out important differences of opinion both as to the composition of the committee and the nature of its task. It is probable that S. Parker Gilbert, the Agent General for Reparation Payments, will be able to resolve these minor difficulties but

1. *New York Herald-Tribune*, Geneva Bureau, September 17, 1928.

2. Popularly known as the Dawes Plan.

the fact that they have been raised indicates an even more fundamental disagreement on matters of greater importance. At this stage, therefore, undue optimism as to the probable achievements of the committee is not justified.

The purpose of this report is to present a general statement of the problems to be faced by the proposed committee of ex-

perts. In order to do this it is necessary to review briefly the background of the present problem and to raise some of the questions involved in fixing the total of German reparation obligations. It also shows the immediate and direct economic connection between reparation and war debts, and, finally, it presents and criticizes proposals for the commercialization of the reparation obligations.

THE PRESENT STATUS OF THE PROBLEM

Although the Experts' Plan has achieved admirable results since its adoption in September 1924, from the point of view of a final solution of the problem there are several obvious defects in its construction. The most important of these is the fact that it leaves indefinite Germany's total liabilities. S. Parker Gilbert, in the Report of the Agent General for Reparation Payments of December 10, 1927, states:

"And as time goes on, and practical experience accumulates, it becomes always clearer that neither the reparation problem, nor the other problems depending upon it, will be finally solved until Germany has been given a definite task to perform on her own responsibility, without foreign supervision and without transfer protection. This, I believe, is the principal lesson to be drawn from the past three years, and it should be constantly in the minds of all concerned as the execution of the Plan continues to unfold."

Under the schedule of payments provided in the present Plan Germany is required to pay to the Allies the sum of 2,500 million gold marks (\$595,000,000) a year in the standard years which began in September 1928. The Experts' Plan does not stipulate how long these payments shall run, nor is there any statement of the total amount Germany shall be required to pay. The Treaty of Versailles fixed a period of thirty years as the duration of German reparation payments.³ The railway and industrial bonds which have been issued under the Plan run for thirty-seven years—a vague and exceedingly uncertain suggestion that this is the duration of the period of payments contemplated by the Experts' Plan. The capitalized sum of the standard Dawes payments is generally reckoned at 50 billion gold marks (about \$12,000,000,000). In

1921 the Reparation Commission, however, fixed the total of German reparation charges at 132 billion gold marks (about \$31,000,000,000), and since this amount has never been subsequently altered, there are many who argue that Germany is legally responsible for that amount.

Another defect of the Experts' Plan is that it leaves untouched the crucial problem of Germany's ability to transfer the payments due. While the Experts' Plan sets up a Transfer Committee to protect the stability of German currency, it does not provide a means for the marketing of German goods and services. Since the adoption of the Experts' Plan, Germany has borrowed more from abroad than she has paid on account of reparation. During this period of time Germany has paid to her creditors approximately \$1,302,000,000 while she has borrowed from abroad more than \$1,550,000,000. Under these conditions there is not likely to be a technical transfer problem since Germany's demand for foreign currency is met by the large sums borrowed. The ultimate effect of this government-paying, private-borrowing process is simply to change gradually the form of Germany's liabilities from government to private debts.

A third objectionable feature of the Experts' Plan is the elaborate system of international financial control that is imposed upon Germany. It is exceedingly irksome, as well as a constant humiliation to Germany, to have practically her entire economic life supervised by the representatives of foreign governments. While this elaborate system of control was obviously necessary at the time of the adoption of the Experts' Plan, only her most violent enemies

³. Treaty of Versailles, Part VIII, Article 233.

would insist that these measures should continue indefinitely.

The debts of the Allied Governments to the Government of the United States constitute perhaps the most important factor in the reparation problem as it stands today. Under the debt-funding agreements the Allies have agreed to pay the United States over a period of sixty-two years. They demand, therefore, that reparation payments from Germany continue as long as they are required to pay the United States. Thus the war debts have become a stumbling block in the way of a settlement of the reparation problem.

While the United States Government has consistently maintained that there is no moral or legal connection between reparation and war debts, a direct and immediate practical connection cannot be doubted. The two problems of war debts and reparation are from a strictly economic point of view only two general aspects of the much larger problem of the financial liquidation of the war. The reparation problem, which is the particular concern of the countries of Europe, requires, in the first instance, a European solution, but a definite and final solution of the larger problem cannot be envisaged without a reconsideration of the inter-Allied debts as well.

Under the Experts' Plan Germany is required to pay the Allies \$595,000,000 a year, while the United States is due to receive from the four principal Allies under the debt-funding agreements payments ranging from \$204,333,750 in 1929 to \$406,000,000 in 1983. The position of the various countries as the recipients of reparation from Germany and the payers of war debts to the United States for the year 1929 is shown as follows:

PAYMENTS DUE IN 1929 UNDER THE EXPERTS' PLAN AND FUNDING AGREEMENTS

Creditors and Debtors

GREAT BRITAIN	
From Germany	\$109,000,000
From France	38,928,000
From Italy	20,680,000
To United States	\$160,590,000
FRANCE	
From Germany	257,700,000
To Great Britain	38,928,000
To United States	32,500,000
ITALY	
From Germany	49,600,000
To Great Britain	20,680,000
To United States	5,000,000
BELGIUM	
From Germany	39,600,000
To United States	5,450,000

The United States is involved in a solution of the reparation problem in still another way; that is, in the financial control exercised by the New York money market. Any solution of the problem that requires the sale of any portion of Germany's obligations on the world's money markets must necessarily take into account both the private American investor and the attitude of Washington toward the flotation of such a loan on the American markets. Thus, even if the question of the war debts is not raised, the policy of Washington with reference to the supervision of foreign loans must be taken into account.

PROBLEMS BEFORE THE NEW COMMITTEE

When the new committee of experts meets it will be confronted with two definite and concrete problems upon the satisfactory solution of which will depend the economic welfare of Europe for some time to come:

1. That of fixing a total sum that Germany will be required to pay.
2. The formulation of a definite scheme for the commercialization of at least a part of the reparation obligations.

THE BACKGROUND OF REPARATION

Under the provisions of the Treaty of Versailles, Germany and her allies accepted "responsibility for causing all the loss and damage to which the Allied and Associated Governments and their nationals have been subjected as a consequence of the war imposed upon them by the aggression of Germany and her allies."⁴ Article 232 of the Treaty required Germany to "make compensation for all damage done to the civilian population of the Allied and Associated Powers and to their property during the period of the belligerency of each as an Allied or Associated Power against Germany by such aggression by land, by sea and from the air, and in general all damage as defined in Annex I hereto."⁵ According to the terms of Annex I, in addition to the payments for reconstruction of the devastated regions and for a long list of other damages, Germany was required to pay pension and separation allowances and the Belgian war debt.

The Treaty of Versailles did not attempt to fix the total bill against Germany for reparation. It established a Reparation Commission, composed only of Allied and Associated representatives, which was instructed to fix the total obligations of Germany by May 1, 1921. The Treaty merely stipulated that Germany should advance to the Allies 20 billion gold marks on account, which would ultimately be deducted from the total amount fixed. Before the date for the fixing of the amount of Germany's bill by the Reparation Commission, however, a dispute arose between Germany and the Allies over the advance of 20 billion gold marks with the result that the Reparation Commission declared Germany in default. The Allies then proceeded on March 8, 1921, to occupy the towns of Düsseldorf, Duisburg, and Ruhrort. They also established a customs wall around the Rhineland and levied taxes on imports from Germany into Allied countries.

On April 27, 1921 (four days before the expiration of the time limit) the Reparation Commission established Germany's

total liability on account of reparation at 132 billion gold marks (\$31,000,000,000), exclusive of the Belgian war debt of four billion gold marks.

THE LONDON AGREEMENT

The Allies did not ask that the total sum fixed by the Reparation Commission be paid at once. The Supreme Council of the Allies, meeting in London, drew up on May 5, 1921 a schedule of payments which they communicated to Germany together with an ultimatum declaring that if Germany did not unconditionally accept the entire plan within six days the Allies would proceed to the occupation of the Ruhr in addition to other military measures. The London Schedule of Payments provided:

1. That Germany should issue three series of bonds; Class A bonds to the amount of 12 billion gold marks, Class B bonds to the amount of 38 billion gold marks, Class C bonds to the amount of 82 billion gold marks—a total of 132 billion gold marks. The "A" and "B" bonds were to be issued at any time the Reparation Commission thought expedient, but the "C" bonds were not to be issued until the Commission was satisfied that German payments under the schedule were sufficient to provide for the payment of the interest and sinking fund of the "C" bonds. Interest on all the bonds was fixed at the rate of 5 per cent and the sinking fund at one per cent per annum.

2. That Germany should pay annually until all the bonds were redeemed two billion gold marks and 26 per cent of the value of German exports.

It should be observed that under the London Schedule of Payments Germany was required to pay only what amounted to interest and amortization on 50 billion gold marks, or about three billion gold marks a year. This is only slightly more than the standard payments under the Dawes Annuities.

On May 11, 1921, under the pressure of the Allied ultimatum, Germany accepted the obligations fixed upon her by the Repara-

4. The Treaty of Versailles, Part VIII, Article 231.

5. Treaty of Versailles, Part VIII, Article 232, Annex I.

tion Commission and the Schedule of Payments imposed by the London agreement. In an attempt to meet the payments provided in the London Schedule, Germany established a Treaty Obligations' Budget. In spite of her efforts, however, the revenues of the German Government were too small to meet the payments required and the government started to print paper money in order to meet its budget deficit. In consequence, wild inflation followed and the mark fell in value upon the exchange markets. While this financial demoralization was taking place, the Reparation Commission in December 1922, upon the initiative of the French, declared Germany in default in the delivery of timber and the French and Belgian Governments sent a "mission of control" into the Ruhr on January 11, 1923.

If the French really expected by these methods to force from Germany the payments due on reparation, they were doomed to disappointment. The finances of Germany merely went from bad to worse and the mark came to be practically valueless by the end of 1923.

THE EXPERTS' PLAN

Out of this situation, involving the complete demoralization of Germany's economic life, and to a very large extent that of all Europe, came the practical expedient of a Committee of Experts to investigate the German budget and German currency. The proposal of an experts' committee to study Germany's capacity to pay was first put

forward by Secretary Hughes in a speech in December 1922. It was not, however, until November of 1923 that the Allies could reconcile their conflicting interests and motives to the extent of acting upon the proposal. The Reparation Commission then established two committees as follows:

1. The Committee of Experts, appointed for the investigation of the German budget and German currency, met in Paris on January 14, 1924. Its membership was: Charles G. Dawes, Chairman, Owen D. Young, United States; Robert M. Kinderley, J. C. Stamp, England; J. Parmentier, Edgar Allix, France; Alberto Pirelli, Federico Flora, Italy; E. Francqui, and Maurice Houtard, Belgium.

2. The second committee, called to investigate the flight of German capital to foreign countries, met in Paris on January 21. Its members were: Reginald McKenna, Chairman, England; Henry M. Robinson, United States; André Laurent-Atthalin, France; Mario Alberti, Italy; and Albert E. Janssen, Belgium.

On April 9 the two committees simultaneously submitted their reports to the Reparation Commission. The report of the first committee was adopted as the basis for the settlement of the reparation impasse at the London Conference on August 16, 1924. The essential features of the Experts' Plan, the foundation upon which the whole structure of European economics and finance has been built since September 1924, is as follows:

Annual German payments were fixed according to the following schedule:

	(in millions of gold marks)				
	first year	second	third	fourth	fifth
From railways	200	595	550	660	660
From reparation loan	800				
From transport tax		250	290	290	290
From industries		125	250	300	300
From sale of preference shares of the railway company			250		
From ordinary budget resources				110	500
Supplementary budget contribution ¹				300	1,250
 TOTALS	 1,000	 1,220	 1,500	 1,750	 2,500

1. The Plan fixed the third Annuity at 1,200 million gold marks. It provided, however, for two contingent supplementary contributions, payable from the German budget in the fourth and fifth Annuity years, amounting in the aggregate to 500 million gold marks. By an agreement between the

Reparation Commission and the German Government, executed September 8, 1925, the two contingent supplementary contributions have been replaced by a single definite payment of 300 million gold marks, to be made during the third Annuity year.

The principle of the distribution of payments from Germany among the Allies was that adopted at Spa, in July, 1920. At that conference the following distribution of payments was agreed upon and is in force at the present time: France, 52 per cent; England, 22 per cent; Italy, 10 per cent; Belgium, 8 per cent.

It will be observed that the annual payments in the standard years under the Experts' Plan are not greatly more than those provided in the London Schedule of Payments of May 5, 1921. There are, however, several very important differences. The Experts' Plan offered definite assistance to Germany. By beginning the payments at a relatively low figure and increasing them year by year to the standard Annuities of the fifth year, they made it possible for Germany to meet her payments gradually. It also provided a loan of 800 million gold marks for the purpose of safeguarding the German budget and currency, and established an independent bank which exercised the exclusive right to issue paper money and thus made inflation for political purposes impossible.

In addition to helping Germany by means of a loan, the Experts' Plan further assisted her by taking a portion of the burden from the budget and placing it upon German industries. It provided that the first year's payments of one billion gold marks should be derived from the proceeds of the foreign loan and from interest on German Railway Bonds pledged for this purpose. The second year's payments were derived from a transport tax, interest on industrial debentures, and interest on German Railway Bonds—deducting only 250 million gold marks from the government budget. In the third year the government budget contributed 110 million gold marks, or about 7 per cent of the total payments for that year. Finally, in the standard years, the budget is required to contribute regularly 1,250 million gold marks or 50 per cent of the total Annuity; the other half is to be contributed by German railways and certain other industries.

The Plan provides that the German Gov-

ernment should issue 5 per cent bonds to the value of 11 billion gold marks, payable in thirty-seven years, and secured by railway earnings; and bonds to the value of five billion gold marks secured by certain industries. In addition, a transport tax was imposed for reparation purposes. Thus the German railways and industries must assume responsibility for meeting the interest and eventually paying off the principal on bonds aggregating 16 billion gold marks.

In order to safeguard the interest of Germany's creditors, the Experts' Plan sets up financial guarantees based upon a system of pledged revenues and international control. In contrast to the military guarantees imposed by the Treaty of Versailles, the Plan provided that Germany should be required to lay aside for reparation payments certain revenues which could not be used for any other purposes. Germany therefore set aside the revenues derived from alcohol, tobacco, beer, sugar and customs. These revenues are under the supervision of a Commissioner of Controlled Revenue who sees to it that the funds are properly administered and that they are actually turned over to the reparation account.

The railways, the Bank of Issue and German Railway Bonds are also placed under the control of foreign commissioners under the general supervision of the Agent General for Reparation Payments. In order to prevent the invasion of German territory by an Allied country, provision is made for the settlement of all disputes between the Reparation Commission and Germany by arbitration. Thus France or any other power cannot decide for itself whether or not Germany has failed to live up to its obligations. If a default occurs, the agreement provides that the Allies, "acting with the consciousness of joint trusteeship for the financial interests of themselves and of the persons who advance money upon the lines of the said Plan, will confer at once on the nature of the sanctions to be applied and on the method of their rapid and effective application."

THE TRANSFER COMMITTEE

Perhaps the most interesting feature of the Experts' Plan was the institution of a Transfer Committee which was charged with the task of converting German marks into the currency of the creditor countries. The Plan provides that:

"All payments for the account of Reparations (whether from interest and sinking fund on railways or industrial debentures, the transport tax, or from the budget contribution) will be paid in gold marks or their equivalent in German currency into the Bank of Issue to the credit of the 'Agent for Reparation Payments'. This payment is the definitive act of the German Government in meeting its financial obligations under the plan."

In other words, the responsibility for the transfer of the funds from German into foreign currency is shifted from the German Government to the hands of the Transfer Committee. Its powers include the suspension, curtailment, expansion, or regulation of remittances in accordance with the capacity of the exchange market to absorb them without threatening the stability of the German currency. If it is thought

essential in the interests of the stability of the German currency to suspend transfers, the Committee may invest reparation funds "in bonds or other loans in Germany" to a maximum of five billion gold marks. When that limit has been reached, the "payments by Germany out of the Budget and Transport Tax would be reduced until such time as the transfers to the Allies can be increased and the accumulation be reduced below the limit named."

Germany has met promptly and efficiently all of her payments in accordance with the stipulations of the Experts' Plan. The stability of her currency has remained unimpaired, and within the last few years she has undergone a period of great internal industrial and business expansion.

Nevertheless, in order to make an economic settlement of her reparation obligations, Germany will be required to have a surplus of exports of goods and services in her balance of international payments sufficiently valuable to meet the amount of her payments on account of reparation. This is the real transfer problem with which Germany is confronted and it is also, perhaps, the real test of her capacity to pay.

WHAT SHALL GERMANY BE REQUIRED TO PAY?

The first and foremost problem which is left unsolved by the Experts' Plan and which the new committee of experts will be forced to face quite concretely is that of fixing the total amount Germany will be required to pay. What procedure will the committee adopt and what principles can be used to determine with any degree of fairness and accuracy the amount that Germany shall be required to pay on reparation account? It is obviously out of the question to go back to the arguments that prevailed at the Peace Conference.

"CAPACITY TO PAY"

The first question that the proposed committee of experts will be called upon to decide is Germany's "capacity to pay." At the present time, under the schedule of payments provided in the Experts' Plan, Germany is required to pay the annual sum of

2,500 million gold marks, or \$595,000,000 a year. Whether this is beyond Germany's capacity to pay it is impossible to say. Moreover, Germany's experience under the Experts' Plan has proved very little with respect to her ability to pay. The full schedule of German payments under the Experts' Plan began only in September 1928. As pointed out in another section of this report, Germany has borrowed from abroad more than she has paid her creditors.

The principle of capacity to pay is itself an uncertain formula. It is not possible of exact and scientific determination. It must be measured, first, by Germany's ability to produce a surplus within the nation for export abroad; and, second, by her ability to sell these goods and services to the outside world. Obviously a nation's ability to produce an internal surplus is almost unlimited, assuming that it is possible to reduce the standard of living of its citizenry to the lowest point consistent with the main-

tenance of mere physical existence. This, of course, is not the conception of capacity to pay that Germany's creditors or the United States Government have in mind in using this principle as the basis for the funding of the Allied debts to the United States. At any rate, such an interpretation of the principle of capacity to pay is one which is quite untenable in our modern economically and politically interdependent world. It also leaves out of consideration entirely the crucial problem of transferring these sums abroad.

STATEMENT OF SECRETARY MELLON

What, then, is a practical conception of economic capacity that may be applied to Germany? One of the best statements of the principle of capacity to pay was made by Andrew Mellon, Secretary of the Treasury of the United States, with reference to the funding of the war debt to the United States. Mr. Mellon said:

"While the integrity of international obligations must be maintained, it is axiomatic that no nation can be required to pay to another government sums in excess of its capacity to pay. The Commission in its settlement with Great Britain, made on June 19, 1923, and in subsequent negotiations or settlements has adhered to the principle that the adjustments made with each Government must be measured by the ability of the particular Government to put aside and transfer to the United States the payments called for under the funding agreement.

"Nor does the principle of capacity to pay require the foreign debtor to pay to the full limit of his present or future capacity. It must be permitted to preserve and improve its economic position, to bring its budget into balance and to place its finances and currency on a sound basis, and to maintain, and if possible to improve the standard of living of its citizens. No settlement which is oppressive and retards the recovery and development of the foreign debtor is to the best interest of the United States or of Europe."⁶

As Secretary Mellon points out, there are two aspects to the problem of economic capacity. The first is the ability of the country in question to create a surplus over and above its normal expenditures and its own internal demands for capital, and the second is the question of converting these funds from the currency of the debtor country into

the currency of the country to which payment is due.

The report of the Experts' Committee recognizes very clearly the dual nature of the test of economic capacity:

"There has been a tendency in the past to confuse two distinct though related questions; i. e., first, the amount of revenue which Germany can raise available for reparation account; and, second, the amount that can be transferred to foreign countries. The funds raised and transferred to the Allies on reparation account cannot in the long run exceed the sums which the balance of payments makes it possible to transfer without currency and budget instability ensuing."

In continuation the report points out that reparation must first be provided for as an item in the budget. It next shows that the economic balance is, by comparison with the budget, incapable of close calculation, "unmanageable" and too elastic. It then says:

"But the limits set by the economic balance, if impossible of exact determination, are real. For the stability of a country's currency to be permanently maintained, not only must her budget be balanced, but her earnings from abroad must be equal to the payments she must make abroad, including not only payments for the goods she imports, but the sums paid in reparation. Nor can the balance of the budget itself be permanently maintained except on the same conditions. Loan operations may disguise the position—or postpone its practical results—but they cannot alter it. If reparation can, and must, be provided by means of the inclusion of an item in the budget—i. e., by the collection of taxes in excess of internal expenditure—it can only be paid abroad by means of an economic surplus in the country's activities."

It should be emphasized that in any reasonable conception of economic capacity, Germany's ability to pay the sum fixed must be reckoned solely upon her own internal capital accumulation without resort to foreign borrowing. While it is true, as Mr. George P. Auld sets forth in his book, *The Dawes Plan and the New Economics*, that Germany might continue for some length of time to pay reparation and at the same time resort to extensive foreign borrowing, it should nevertheless be observed that as long as this process continues, Germany is not liquidating any portion of her total obligations, but merely transferring them from public to private obligations. A true

⁶. Annual Report of the Secretary of the Treasury, June, 1925. Washington, Government Printing Office.

conception of capacity to pay, therefore, requires that Germany raise and transfer these sums unaided.

Thus Germany must be able not only to produce out of her own internal economy a surplus to meet her payments abroad, but she must also be prepared to transfer these sums into Allied currency without the protective features provided by the Transfer Committee in the Experts' Plan.

WAR DEBTS AND REPARATION

The second consideration that the new committee of experts must take into account in fixing the total of Germany's reparation liabilities is that of the relationship between the war debts owed by the Allied Governments to the United States and the sums due on account of reparation from Germany. It should be noticed that from the very outset the United States has refused to recognize any connection whatsoever between war debts and reparation, and from a purely legal point of view no such connection exists.

The war debts to the United States of France, Great Britain, Italy and Belgium were contracted for the purpose of paying for war supplies purchased by these governments in the United States. In this sense they were purely commercial transactions. In other words, the Government of the United States accepted the notes of the various Allied Governments for value received in the form of munitions and other materials. There is nothing in the various Acts passed by Congress authorizing these loans to indicate that it involved anything other than a purely business transaction. According to available records there is no evidence whatsoever that the United States Government has ever officially regarded the Allied debts to the United States in any other light.

The first official expression of opinion with regard to the American Government's attitude toward the war debts was contained in a communication from President Wilson to Mr. Lloyd George of August 5, 1920, which read in part as follows:

"No power has been given by the Congress to any one to exchange, remit or cancel any part of the indebtedness of the Allied Governments

to the United States represented by their respective demand obligations. It would require Congressional authority to authorize any such dealing with the demand obligations. . . It is highly improbable that either Congress or popular opinion in this country will ever permit a cancellation of any part of the debt of the British Government to the United States in order to induce the British Government to remit, in whole or in part, the debt to Great Britain or France, or any other of the Allied Governments, or that it would consent to a cancellation or reduction in the debts of any of the Allied Governments as an inducement toward a practical settlement of the reparation claims."

The Congressional attitude toward the payment of the debts was not pressed until 1922 when Congress passed an Act creating a World War Foreign Debt Commission, and laid down the principles which were to govern the American representatives in the negotiations of debt settlements. The significant features of this Act were the instructions to the American Debt-Funding Commission, which empowered the Commission, with the approval of the President, to fund the war and relief obligations of the various foreign governments "in such form and on such terms, conditions, date or dates of maturity, and rate or rates of interest, and with such security as shall be deemed to the best interest of the United States of America."

And it was provided "that nothing contained in this Act shall be construed to authorize or empower the Commission to extend the time of the maturity of any such bonds or other obligations due the United States of America by any foreign government beyond June 13, 1947, or to fix the rate of interest at less than 4 1/4 per cent per annum." The Act further provided that the Commission had no authority to exchange bonds or other obligations "of any foreign government for those of any other foreign government or cancellation of any part of such indebtedness except through payment thereof."

The only change in the attitude of Congress has been to authorize the various debt-funding agreements which have been negotiated. The United States Government is therefore unwilling to admit the connection between reparation, which was imposed

upon Germany by victors in the war in order to pay for damages which it inflicted upon the lives and property of the civilian population of the Allied countries, and obligations to the United States which were acquired for the purpose of paying the United States for supplies received by those countries.

In spite of the fact, however, that there is no moral or legal connection between reparation and war debts, it is impossible to deny that there is a definite practical and economic connection. The Finance Ministers of the various European countries in making up their budgets, which require the payment of large annual sums to the United States, are forced to consider the revenues to be derived from German reparation. In order to get a clear idea of the position of

the four European countries which at the same time are debtors and creditors of the United States and Germany respectively, it is necessary to review briefly the financial receipts and payments of each of these countries separately.

The Position of Great Britain

Great Britain occupies the middle position between Germany, the general debtor, and the United States, the general creditor. Its annual payments to the United States are approximately equal to its annual receipts in reparation from Germany and the annual payments of war debts from France and Italy.

The following table shows the position of Great Britain with respect to reparation and war debts for the next five years:

GREAT BRITAIN

Year	RECEIPTS from			Total Receipts	PAYMENTS to United States
	Germany	France	Italy		
1929	\$109,000,000	\$ 38,928,000	\$ 20,680,500	\$168,608,500	\$160,590,000
1930	109,000,000	48,660,000	20,680,500	178,340,500	160,780,000
1931	109,000,000	60,825,000	20,680,500	190,505,500	159,940,000
1932	109,000,000	60,825,000	20,680,500	190,505,500	161,100,000
1933	109,000,000	60,825,000	21,897,000	191,722,000	183,900,000
Total for five-year period	\$545,000,000	\$270,063,000	\$104,619,000	\$919,682,000	\$826,310,000

British Policy

The policy of Great Britain with respect both to its debtors and its creditors remains as it was announced on August 1, 1922. At that time, Lord Balfour, British Secretary for Foreign Affairs, outlined Britain's position in the famous Balfour Note as follows:

"The policy favoured by His Majesty's Government is, as I have already observed, that of surrendering their share of German reparation, and writing off, through one great transaction, the whole body of inter-Allied indebtedness. But, if this be found impossible of accomplishment, we wish it to be understood that we do not in any event desire to make a profit out of any less satisfactory arrangement. In no circumstances do we propose to ask more from our debtors than is necessary to pay to our creditors. And, while we do not ask for more, all will admit that we can hardly be content with less."

This policy announced by Lord Balfour remains the keynote of the British debt policy. The British representatives have been careful to reiterate that any agreement which preserves the essential principles of the Balfour Note will be acceptable to them. In making agreements with her debtors, Great Britain followed rigidly the logic of the Balfour declaration. In both the French

and the Italian agreements a provision was inserted by which Great Britain agreed to reimburse the Italian and French Governments for all payments made to Great Britain in excess of the amount Great Britain was required to pay the United States. The provision in the Anglo-Italian agreement is as follows:

"If at any time it appears that the aggregate payments effectively received by Great Britain under Allied war debt-funding agreements and on account of reparations or of liberation bonds exceed the aggregate payments effectively made by Great Britain to the Government of the United States of America in respect of war debts, an account shall be drawn up by the British Treasury, interest at 5 per cent being allowed on both sides of the account; and if that account shows that the receipts exceed the payments, Great Britain will credit Italy against the payments next due by Italy under Article I of this Agreement, with such proportion of that excess as the payments effectively made by Italy, under Article 1 of this Agreement, bear to the aggregate sums effectively received by Great Britain under all Allied war debt-funding agreements. Thereafter, a similar account will be drawn up by the British Treasury each year, and any further excess of the receipts over the payments shall each year give rise to a credit to Italy of a proportion of such excess calculated

in the manner indicated above. On the other hand, any deficit shall be made good by an increase in the payments next due by Italy up to a similar proportion of such deficit within the limit of the total amount of the credits already allowed to Italy under this article."

The Position of France

France and Belgium are the two nations

Year	RECEIPTS from	
	Germany	
1929	\$257,700,000	
1930	257,700,000	
1931	257,700,000	
1932	257,700,000	
1933	257,700,000	

Totals for five-year period\$1,288,500,000

France has consistently taken the position that she would insist not only upon reparation large enough to meet her war debt obligations, but also a surplus to compensate her for the war-time invasion of her territory. The losses suffered by France in the destruction of factories, mines, railroads, farms, and homes in the northern part of that country have been estimated at \$6,500,000,000.⁷

On September 30, 1928, at the unveiling of a war monument in the village of Chambery, Premier Poincaré declared:

"Whatever settlement is made should guarantee us from our debtors besides the total pay-

FRANCE

	PAYMENTS to		Total Payments
	Great Britain	United States	
	\$ 38,928,000	\$ 32,500,000	\$ 71,428,000
	48,660,000	35,000,000	83,660,000
	60,825,000	40,000,000	100,825,000
	60,825,000	50,000,000	110,825,000
	60,825,000	60,000,000	120,825,000

\$270,063,000 \$217,500,000 \$487,563,000

ment of what we owe our creditors—a clear indemnity for war damages."

The only doubtful element in the French position is the amount that she will insist upon as "a clear indemnity."

The Position of Belgium

The policy of Belgium is the same as that of France in that she insists upon reparation payments from Germany not only sufficient to meet her obligations to the United States but also to provide her with an indemnity on account of war losses. Belgium's position with respect to receipts and payments is as follows:

BELGIUM

Year	RECEIPTS from	
	Germany	
1929	\$39,600,000	
1930	39,600,000	
1931	39,600,000	
1932	39,600,000	
1933	39,600,000	

Totals for
five-year period\$198,000,000

	PAYMENTS to	
	United States	
	\$ 5,450,000	
	6,200,000	
	7,309,000	
	7,950,000	
	8,450,000	

\$35,359,000

The Position of Italy

The Italian Government has repeatedly stated that it would not consent to any reduction whatsoever of the reparation payments due from Germany unless there was a compensating reduction in the amount she is required to pay Great Britain and the

United States. It has also stated that should there be any diminution of the annual payments from Germany, Italy will be forced to demand a higher percentage of reparation than she is now receiving.⁸ Italy's debtor-creditor position is shown for the next five years in the following table:

ITALY

Year	RECEIPTS from	
	Germany	
1929	\$ 49,600,000	
1930	49,600,000	
1931	49,600,000	
1932	49,600,000	
1933	49,600,000	

Totals for five-year period\$238,000,000

	PAYMENTS to		Total Payments
	Great Britain	United States	
	\$ 20,680,500	\$ 5,000,000	\$ 25,680,500
	20,680,500	5,000,000	25,680,500
	20,680,500	14,621,250	35,301,750
	20,680,500	14,706,125	35,386,625
	21,897,000	14,790,875	36,687,875

\$104,619,000 \$ 54,118,250 \$158,737,250

7. Auld, G. P. *The Dawes Plan and the New Economics*. New York, Doubleday, Page, 1927.

8. *New York Times*, November 16, 1928.

THE COMMERCIALIZATION OF WAR OBLIGATIONS

The second problem with which the proposed committee of experts will be confronted is that of considering proposals for the liquidation of at least a part of the reparation obligations by selling them upon the open market. The general idea of the sale of German reparation bonds to private investors has been discussed informally ever since the end of the war. The commercialization of the Allied indebtedness to the United States has also been a possibility. The debt-funding agreements with the several Allied Governments contain a provision stipulating that the United States may sell the bonds of the debtor nations on the open market on condition that they are first offered for sale to the nation which originally issued them.

The proposal to commercialize a portion of the reparation bonds was first officially proposed on September 16, 1926 at the famous luncheon at Thoiry between Foreign Minister Briand of France, and Foreign Minister Stresemann of Germany. At the time of this conversation, France was in immediate need of cash to be used in stabilizing the franc and she was prepared to bargain on a cash basis for the withdrawal of the troops from the Rhineland. The Thoiry plan was not put into execution. The essential idea behind it, however, has never been abandoned and only within the last few months discussion of it has been revived in foreign press dispatches.

As originally proposed, the Thoiry project called for the sale of a portion of the bonds of the German Railway Company which are now held by the Reparation Commission under the Experts' Plan. These bonds were to be marketed in the form of preferred shares and the proceeds turned over to France and Belgium in return for the evacuation of German soil by French troops. Another allotment of the bonds, according to this plan, were to be marketed and the cash turned over to France and Belgium for the purpose of stabilizing their currencies.

Since the Stresemann-Briand luncheon, several more ambitious plans have been informally suggested in international financial circles. One of the most comprehensive of these contemplates the complete liquidation

of the war obligations in one great financial transaction. In very general terms this plan proposes:

1. That Germany's obligations be fixed at a sum which is roughly comparable to the capitalized cash value of the Allied indebtedness to the United States, plus an indemnity to France and Belgium.
2. That the entire amount of these obligations be issued in the form of bonds upon the security of German railroads and industry and the German Government, and that these bonds be turned over to the Allies for sale upon the open market.
3. That the proceeds from the sale of these bonds will be distributed as follows:
 - a. France will receive a cash payment, the "clear indemnity" that M. Poincaré insists upon, over and above her payments to the United States. This payment would, of course, be considerably less than the original French demands for reconstruction purposes.
 - b. Belgium would also receive a cash payment as an indemnity over and above what she is required to pay Great Britain and the United States.
 - c. The remaining amount would be paid to the United States for the purpose of settling the Allied indebtedness to this country.

While this plan has many things to recommend it, there are nevertheless practical difficulties in the way of its execution. The first is that of getting an agreement between Germany and her creditors as to the amount that Germany will be required to pay. Germany's total obligations must be small enough to be marketed, and at the same time large enough to supply all the Allied demands for reparation. The capitalized figure of the Dawes Annuities is \$12,000,000,000. It is highly questionable if more than \$5,000,000,000 could be sold, and it is doubtful if France, Belgium and the other Allies would accept this as the final sum of German reparation obligations. The Germans would probably insist that while this is a considerable reduction in the amount they are not required to pay, it is still beyond their economic capacity.

The second difficulty is that of marketing the bonds. Estimates of the amount of German securities it would be possible to sell

on the world's money markets vary from \$3,000,000,000 to \$5,000,000,000. Many practical bankers agree that \$4,000,000,000 worth of these bonds could be marketed, while others contend that it would be

German Railway Bonds	Mks. 11,000,000,000	(\$2,618,000,000)
German Industrial Debentures	5,000,000,000	(1,190,000,000)
TOTAL	Mks. 16,000,000,000	(\$3,808,000,000)

If Germany's obligations could be fixed at the definite sum of \$4,000,000,000 or \$5,000,000,000, a satisfactory marketing arrangement could possibly be worked out. It would, of course, be necessary for the Allied Governments to guarantee the bonds to the extent of their indebtedness to the United States. It would also probably be necessary for such a loan to secure the co-operation not only of the international bankers, but also of the Treasury of the Federal Reserve System, and private bankers in the United States.

While it is true that such financial centers as London, Paris, Amsterdam and Berlin would be able to take some of these bonds, the total amount that could be sold abroad

possible to market \$5,000,000,000 worth under an orderly marketing arrangement.

The German securities which at present are being held by the German Reparation Commission are as follows:

German Railway Bonds	Mks. 11,000,000,000	(\$2,618,000,000)
German Industrial Debentures	5,000,000,000	(1,190,000,000)
TOTAL	Mks. 16,000,000,000	(\$3,808,000,000)

is likely to be small in relation to the American quota. Moreover, it is thought that unless the major portion of these bonds are floated in the American market, the problem would immediately arise as to how such large amounts of pounds, francs and marks could be transferred to the United States in payment of the war debts.

During the last calendar year, England subscribed for only about \$100,000,000 worth of foreign securities, and even smaller amounts were taken by other continental countries. The following table shows the amounts of new foreign securities floated in the American market in the post-war years.

FOREIGN SECURITIES PUBLICLY OFFERED IN THE UNITED STATES (Nominal capital less refunding)

1919	\$562,324,400	1924	\$ 928,493,742
1920	585,191,357	1925	1,085,380,750
1921	631,007,880	1926	1,134,659,650
1922	682,277,984	1927	1,375,713,060
1923	413,662,100	1928*	978,414,237

*Nine months, ended September 30, 1928.

The above record of foreign financing in the United States would tend to cast doubt on the ability of the American market to absorb the large amount of securities which would be allotted to it under the plan. It must be remembered, however, that there is a very elastic demand for investment securities.

The major portion of the bonds would have to be floated in the United States not only because of the superior buying power of the American market, but also because of the difficulty of transfer. If funds were to be taken from private investors and paid to the Federal Government, there would obviously be no transfer problem. If, however, funds were raised from private investors in England to be turned over to the United States Treasury, it would be neces-

sary for the English to use their gold reserve in order to pay for the bonds, since it would be quite impossible, without minor loans from the United States to England, to secure the necessary dollar exchange to transfer to the United States. The same applies to the private investor in Germany, France and the other countries, and since only England and France, and possibly Switzerland and Holland, have a surplus of gold which might be transferred, it is only these countries that could possibly help in buying German bonds.

Because of the difficulty of getting an agreement on the total sum of German reparation liabilities, several variations of the preceding plan have been proposed. One of the most interesting of these suggestions is that of discounting present payments. In

other words, if after a careful survey of marketing conditions it is found possible to sell \$5,000,000,000 worth of German bonds on the world's money markets, these bonds will be sold and the proceeds applied to discounting payments of reparation and war debts, leaving open the entire amount Germany will be required to pay. This plan is based upon the proposition that Europe should have immediate relief from the burden of debts in order to recover. After fifteen or twenty years of financial rest, the productive power and the capital accumulation of Europe will have increased so greatly, it is argued, that she would then have no difficulty in meeting her obligations. The main outlines of the plan are as follows:

1. Germany will sell \$5,000,000,000 worth of her bonds on the world's money markets, thereby reducing her annual payments to approximately \$300,000,000 a year, or about one-half the standard Dawes Annuities—all of which will be in the form of interest and amortization on her outstanding bonds.

2. The proceeds of the sale of these bonds will be distributed as follows:

- a. France will receive on account a cash payment toward the "clear indemnity" that M. Poincaré insists upon, over and above her payments to the United States. This payment would not amount to more than \$500,000,000 and the total amount would be left open for the future.

- b. Belgium would also receive a cash payment of, let us say, \$150,000,000 on account, as an indemnity over and above what she is required to pay the United States.

- c. The remainder of \$4,325,000,000 would be paid to the United States for the purpose of discounting the Allied Governments' payments to the United States under the debt-funding agreements. The annual payments that this sum would discount must be worked out precisely by an actuary.

- d. At the end of the period of time discounted by these cash payments to the United States, (e.g., 20 years) present reparation obligations will automatically become effective and the powers concerned will be able either to resume payment under present schedules, as provided in the Experts' Plan and the debt-funding agreements, or, as seems more probable, to proceed to reach a new agreement based upon changed conditions.

There are certain obvious criticisms which might be made against this proposal. The first is that it would leave the whole

question open to future settlement. A bond issue of \$5,000,000,000 based upon a generous discount rate would cover so large a proportion of the debts to the United States that it would be a mistake not to settle the whole problem in one transaction. It would also seem unnecessary to clutter up the commercialization feature of the compromise plan by including the "clear indemnity" that France and Belgium insist upon. These indemnities could better be paid by a separate agreement between Germany and those countries, providing for payments in kind to the amount of the indemnity asked. While there is still hope of bringing about a final liquidation of the war obligations, it would be a mistake to adopt any plan which fell short of a complete settlement.

In any plan for the commercialization of war obligations the most important difficulty to be overcome would be that of securing the cooperation of the United States Government which has consistently taken the position that there is no connection between reparation and war debts. As far as the United States Government is concerned, therefore, the whole war debt problem is a closed issue. This stand on the part of the American Government is undoubtedly a reflection of the sentiment of a vast majority of the American people. The 1928 platform of the Republican Party said:

"We have steadfastly opposed and will continue to oppose cancellation of foreign debts. We have no desire to be oppressive or grasping, but we hold that obligations justly incurred should be honorably discharged. We know of no authority which would permit public officials, acting as trustees, to shift the burden of the war from the shoulders of foreign taxpayers to those of our own people. We believe that the settlements agreed to are fair to both the debtor nation and to the American taxpayer. Our Debt Commission took into full consideration the economic conditions and resources of the debtor nations, and were ever mindful that they must be permitted to preserve and improve their economic position, to bring their budgets into balance, to place their currencies and finances on a sound basis and to improve the standard of living of their people. Giving full weight to these considerations, we know of no fairer test than ability to pay, justly estimated."

"The people can rely on the Republican Party to adhere to a foreign debt policy now definitely established and clearly understood both at home and abroad."

Several European nations have evidently accepted this decision on the part of the American Government as final. The British representatives, for example, in September 1928, shortly after the agreement for the appointment of a new committee of experts to reconsider the question of reparation, were very careful to point out that their action did not imply a request for the United States to reconsider its debt policy.

In spite of this policy, it is argued that there could be no objection on the part of the United States Government to a cash offer for the discount of the Allied obligations, providing that this offer did not in effect cancel any portion of the Allied indebtedness. It is argued that it would be more desirable for the United States to receive a cash settlement rather than wait for payment in annual installments over a period of fifty-nine more years. It would give the United States Government cash with which to redeem immediately a part of its public indebtedness.

There remains, however, the difficult question of constitutional procedure. Congress might be reluctant to give United States Treasury representatives the option to negotiate such a commercialization arrangement for the settlement of inter-Allied debts to the United States. Under our peculiar political arrangements, it would probably be necessary for Congress to pass upon such a scheme before it could be carried into effect by the Executive.

In view of these conditions any scheme for the commercialization of war debts and reparation must depend in the first instance upon a European solution of the problem; that is, the total amount of German obligations must be fixed and a definite plan be worked out for the sale of these securities upon the world's money markets. When this has been accomplished it will then be possible to make a definite offer to the United States which she is left free either to accept or reject.

Even if the plans for the liquidation of reparation were a purely European arrangement and did not involve the Allied war debts to the United States, it would nevertheless be necessary to obtain the approval of the American Government before bonds

could be floated privately upon the American market.

SUMMARY OF CONCLUSIONS

It is obvious that there is no simple solution of the interrelated problems of reparation and war debts. The capital represented by these obligations has been shot away in one of the most disastrous wars in history and the world is now undergoing the painful and unromantic process of paying the bill. From the foregoing statement of the problem, however, it is possible to set limits within which a constructive attack can be made upon it.

The first and most pressing need, if a final solution of the problem is contemplated, is for a definite statement of Germany's obligations. This is demanded not only because the German people have a right to know what is expected of them but also in order that the people of the Allied countries may know how they are to meet their own obligations under the war debts. In fixing the amount that Germany shall be required to pay, Germany's true economic capacity must be honestly determined.

The most important factor in determining Germany's capacity to pay is in finding out how much she can reasonably be expected to transfer to foreign countries in goods and services unaided by a transfer committee, and without resorting to foreign borrowing. There are several possible ways by which Germany can secure the foreign exchange to meet her pound, franc and lira debts abroad.

1. The first is by a change in her present trade balance of such magnitude that it will not only wipe out her present excess of imports over exports but also give her an export balance sufficiently large to meet her annual reparation payments. In order to do this, Germany must find foreign markets. In this, however, she will be handicapped by the high tariff policies of most of the nations of the world.

2. The second method by which Germany can meet the obligations fixed upon her is by acquiring a heavy export balance in the so-called "invisible" items; e. g., tourist expenditures, freight payments, in-

surance transactions, etc. This must be sufficiently large to offset both the import balance on merchandise and precious metals and at the same time take care of her reparation obligations.

It is obvious that any combination of the two methods outlined above would bring about the same result. The important fact is that Germany must have an export balance on all current items (visible and invisible) sufficient to meet her payments to her creditors.

3. Finally, it is possible for Germany to pay the amount fixed without an export balance on these items provided she continues to borrow the amount she is required to pay. This, in fact, is what she has been doing since the adoption of the Experts' Plan. It is obvious that by this method she is not making a real settlement of her obligations but only changing their form. It is impossible for this situation to continue indefinitely. Sooner or later her pay-

ments will become so large that default in her obligations is inevitable.

Assuming that Germany's obligations have been fixed within a reasonable and economic conception of her capacity to pay, the problem that remains is one of taking the whole matter out of politics and putting her obligations in the hands of private investors. This is involved in the so-called commercialization arrangements outlined above.

In order to do this, it is necessary to take account of the Allied indebtedness to the United States. When the European Governments have agreed upon the amounts Germany shall be required to pay, they will then be in a position to make a cash offer to the United States with some assurance of at least its sympathetic consideration. When it becomes clear that the United States will receive cash with which to pay off a portion of its public debt, there is the possibility that the offer may be accepted.

ANNUAL PAYMENTS TO BE MADE FROM 1929 TO 1933 UNDER EXPERTS' PLAN AND DEBT-FUNDING AGREEMENTS⁹

GREAT BRITAIN

<i>Year</i>	<i>DEBTOR</i>	<i>CREDITOR</i>
1929	<i>Germany</i>	<i>United States</i>
\$109,000,000	\$38,928,000	\$160,590,000
1930	109,000,000	160,780,000
1931	109,000,000	159,940,000
1932	109,000,000	161,100,000
1933	109,000,000	183,900,000

FRANCE

<i>Year</i>	<i>DEBTOR</i>	<i>CREDITORS</i>
1929	<i>Germany</i>	<i>United States</i>
\$257,700,000	\$38,928,000	\$32,500,000
1930	257,700,000	48,660,000
1931	257,700,000	60,825,000
1932	257,700,000	60,825,000
1933	257,700,000	60,825,000

ITALY

<i>Year</i>	<i>DEBTOR</i>	<i>CREDITORS</i>
1929	<i>Germany</i>	<i>United States</i>
\$49,600,000	\$20,680,500	\$ 5,000,000
1930	49,600,000	20,680,500
1931	49,600,000	20,680,500
1932	49,600,000	20,680,500
1933	49,600,000	20,680,500

BELGIUM

<i>Year</i>	<i>DEBTOR</i>	<i>CREDITOR</i>
1929	<i>Germany</i>	<i>United States</i>
\$39,600,000	\$5,450,000	
1930	39,600,000	6,200,000
1931	39,600,000	7,309,000
1932	39,600,000	7,950,000
1933	39,600,000	8,450,000

9. Payments under the Experts' Plan may vary according to the index of prosperity provided in the Plan.